Financial statements and report of independent certified public accountants

Canaan Resources, LLC

December 31, 2018 and 2017

Grant Thornton

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Members
Canaan Resources, LLC

We have audited the accompanying financial statements of Canaan Resources, LLC (a Delaware limited liability company) (the "Company"), which comprise the balance sheets as of December 31, 2018 and 2017, and the related statements of operations, members' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's responsibility for the financial statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility
Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

GrantThornton

Emphasis of matter regarding going concern

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note A to the financial statements, the Company did not make a debt payment requested by its lender as of March 31, 2019 and the note payable matures on June 30, 2019. As of December 31, 2018, the Company's current liabilities exceeded its current assets by $17.7 million. These conditions, along with other matters set forth in Note A, raise substantial doubt about the Company's ability to continue as a going concern. Management's evaluation of the events and conditions and management's plans in regard to these matters are also described in Note A. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this manner.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Canaan Resources, LLC as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Oklahoma City, Oklahoma
April 23, 2019

Canaan Resources, LLC

BALANCE SHEETS

December 31,

	2018	2017
ASSETS		
Current assets		
Cash and cash equivalents	**$ 3,495,419**	$ 4,486,658
Accounts receivable		
Oil and natural gas sales	**1,751,866**	1,532,278
Due from affiliates	**1,056,106**	746,027
Other	**85,409**	78,242
Derivative instruments, short-term	**534,147**	1,704,672
Other current assets	**283,707**	356,326
Total current assets	**7,206,654**	8,904,203
Property and equipment		
Oil and natural gas properties, based on the full cost method of accounting	**321,792,211**	316,798,969
Other equipment	**3,233,319**	3,223,895
Less accumulated depreciation, depletion, amortization and impairment	**(266,499,909)**	(261,871,533)
	58,525,621	58,151,331
Derivative instruments, long-term	**43,906**	-
Other assets, net	**34,976**	50,791
Total assets	**$ 65,811,157**	$ 67,106,325
LIABILITIES AND MEMBERS' EQUITY		
Current liabilities		
Accounts payable - trade and accrued expenses	**$ 3,265,439**	$ 545,109
Revenue payable	**89,214**	80,135
Derivative instruments, short-term	**104,425**	-
Accrued interest payable	**434,288**	471,461
Note payable to bank	**21,000,000**	-
Total current liabilities	**24,893,366**	1,096,705
Note payable to bank	**-**	24,900,000
Asset retirement obligations	**5,155,683**	4,600,574
Commitments and contingencies (Note F)		
Members' equity	**35,762,108**	36,509,046
Total liabilities and members' equity	**$ 65,811,157**	$ 67,106,325

The accompanying notes are an integral part of these statements.

Canaan Resources, LLC

STATEMENTS OF OPERATIONS

Years ended December 31,

	2018	2017
Revenues		
Oil and natural gas sales	$ 12,082,929	$ 13,755,909
Natural gas gathering income	8,893	10,725
Gain on natural gas derivatives, net	387,807	1,001,533
Other	416,330	41,839
Total revenues	12,895,959	14,810,006
Costs and expenses		
Production taxes	2,378,462	2,160,785
Lease operating expenses	2,314,725	2,160,571
Depreciation, depletion, amortization and accretion	4,561,910	4,503,858
Impairment of oil and natural gas properties	399,451	-
General and administrative	2,528,367	2,447,544
Interest	1,459,982	1,363,880
Total costs and expenses	13,642,897	12,636,638
Net (loss) income	$ (746,938)	$ 2,173,368

The accompanying notes are an integral part of these statements.

Canaan Resources, LLC

STATEMENT OF MEMBERS' EQUITY

Years ended December 31, 2018 and 2017

		Members' equity
Balance at January 1, 2017	$	34,085,678
Capital contributions		250,000
Net income		2,173,368
Balance at December 31, 2017		36,509,046
Net loss		(746,938)
Balance at December 31, 2018	$	35,762,108

Canaan Resources, LLC

STATEMENTS OF CASH FLOWS

Years ended December 31,

	2018	2017
Cash flows from operating activities		
Net (loss) income	$ (746,938)	$ 2,173,368
Adjustments to reconcile net loss to net cash provided by operating activities		
Depreciation, depletion, amortization and accretion	4,561,910	4,503,858
Impairment of oil and natural gas properties	399,451	-
Amortization of deferred loan costs	80,450	87,157
Gain on derivative contracts, net	(387,807)	(1,001,533)
Settlements on derivative contracts, net	1,618,851	(492,685)
Gain on sale of other equipment	(1,000)	-
Changes in assets and liabilities:		
Increase in accounts receivable and other assets	(154,136)	(173,528)
Increase in due from affiliates	(310,079)	(277,333)
(Decrease) increase in accounts payable and accrued expenses	(149,971)	49,958
Increase (decrease) in revenue payable	9,079	(6,502)
Net cash provided by operating activities	4,919,810	4,862,760
Cash flows from investing activities		
Acquisition and development of oil and natural gas properties	(1,929,991)	(592,232)
Acquisition of other equipment	(17,424)	-
Proceeds from disposal of other equipment	1,000	-
Net cash used in investing activities	(1,946,415)	(592,232)
Cash flows from financing activities		
Repayments of debt	(3,900,000)	(2,500,000)
Capital contributions	-	250,000
Payment of debt issuance costs	(64,634)	(18,457)
Net cash used in financing activities	(3,964,634)	(2,268,457)
Net (decrease) increase in cash and cash equivalents	(991,239)	2,002,071
Cash and cash equivalents at beginning of period	4,486,658	2,484,587
Cash and cash equivalents at end of period	$ 3,495,419	$ 4,486,658
Supplemental cash flow information:		
Cash payments for interest	$ 1,416,601	$ 1,244,354

Noncash investing and financing activities:

During 2018 and 2017, the Company recorded a net asset and related liability of $230,125 and ($127,378), respectively, associated with the asset retirement obligations on oil and natural gas properties (Note A-14).

As of December 31, 2018, the Company had $2,833,128 of accrued capital expenditures included in "Oil and natural gas properties, based on the full cost method of accounting" in the balance sheet.

The accompanying notes are an integral part of these statements.

Canaan Resources, LLC

NOTES TO FINANCIAL STATEMENTS

December 31, 2018 and 2017

NOTE A - NATURE OF OPERATIONS AND SUMMARY OF ACCOUNTING POLICIES

Canaan Resources, LLC (the "Company") is a Delaware limited liability company ("LLC") engaged in the acquisition, development and production of oil and natural gas properties in the Mid-Continent region of the United States. The Company was formed April 29, 2005 with a perpetual term, and is the sole portfolio investment of three Delaware limited partnerships, Canaan Natural Gas Fund IX, L.P., Canaan Natural Gas Parallel Fund IX, L.P. (through its subsidiaries, Canaan Parallel Fund IX Subsidiary, LLC and Canaan Parallel Fund IX Blocker, LLC) and Canaan Natural Gas Parallel B Fund IX, L.P. No member is individually or personally liable for the Company's expenses, liabilities, debts or obligations. At December 31, 2018, the ownership of the Company was as follows:

Canaan Natural Gas Fund IX, L.P.	39.076%
Canaan Natural Gas Parallel Fund IX, L.P.	58.814%
Canaan Natural Gas Parallel B Fund IX, L.P.	2.110%
	100.000%

Accounting policies employed by the Company reflect industry practices and conform to accounting principles generally accepted in the United States of America. A summary of the significant accounting policies consistently applied in the preparation of the accompanying financial statements follows.

1. Cash and Cash Equivalents

The Company considers all highly liquid debt instruments purchased with a maturity of three months or less and money market accounts to be cash equivalents. The Company maintains its cash and cash equivalents in bank deposit accounts and money market accounts which may not be federally insured. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on such accounts.

2. Accounts Receivable

The Company has receivables from oil and natural gas purchasers and joint interest owners, which are generally uncollateralized. The Company reviews these parties for credit worthiness and general financial condition. The Company determines its allowance for doubtful accounts by considering the length of time past due, previous loss history and the creditor's ability to pay its obligations, among other things. The Company writes off accounts receivable when they are determined to be uncollectible. At December 31, 2018 and 2017, management considers accounts receivable to be fully collectible; accordingly, no allowance for doubtful accounts is required.

3. Oil and Natural Gas Properties

The Company utilizes the full cost method of accounting for oil and natural gas properties. Under this method of accounting, all costs incident to the acquisition, exploration and development of properties (both developed and undeveloped), including costs of abandoned leaseholds, delay lease rentals, unproductive wells, and well drilling and equipment costs, are capitalized. These costs, as well as future development costs on proved undeveloped properties, are amortized using the units-of-production method. The units-of-production method is based primarily on estimates of reserve quantities.

Canaan Resources, LLC

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE A - NATURE OF OPERATIONS AND SUMMARY OF ACCOUNTING POLICIES - CONTINUED

3. Oil and Natural Gas Properties - continued

These reserve estimates were valued using guidelines required by the Securities and Exchange Commission and the Financial Accounting Standards Board. Prior to applying differentials, as required by the rules, the prescribed prices (using an average of the first-day-of-the-month price for the preceding 12-month period) for the year ended December 31, 2018 were $3.10 per thousand cubic feet (Mcf) for natural gas and $65.56 per barrel for oil and natural gas liquids, as compared with the year ended December 31, 2017 prescribed prices of $2.98 per thousand cubic feet (Mcf) for natural gas and $51.34 per barrel for oil and natural gas liquids. These reserve estimates were evaluated by an independent third party reserve engineering firm. All prices are held constant for the life of the properties. Generally, no gains or losses are recognized on the sale or disposition of oil and natural gas properties.

If the Company's unamortized oil and natural gas property costs exceed the cost center ceiling (defined as the sum of the present value, discounted at 10%, of estimated future net revenues from proved reserves plus the lower of cost or estimated fair value of unproved properties), the excess is charged to expense in the year in which the excess occurs. For the year ended December 31, 2018, the Company recorded a ceiling test impairment of oil and natural gas properties of $399,451. No impairment was recorded for the year ended December 31, 2017. The amount of future impairment, if any, will depend on the oil and natural gas prices used, changes in proved reserves and forecasted capital expenditures.

Oil and natural gas properties not subject to amortization consist of the cost of unproved leasehold and totaled $16,820,290 and $17,605,000 at December 31, 2018 and 2017, respectively. These costs are reviewed periodically by management for impairment, with the impairment provision included in the costs of oil and natural gas properties subject to amortization and the ceiling test. Factors considered by management in its impairment assessment include drilling results by the Company and other operators, the terms of oil and natural gas leases not held by production, and available funds for exploration and development.

4. Other Equipment

Other equipment is recorded at cost and consists of office, field and transportation equipment and leasehold improvements. Repairs and maintenance which do not extend the useful lives of property are charged to expense as incurred. Depreciation over the estimated useful lives of other equipment is determined on the straight-line method at the following rates:

Field and office equipment	3 - 20 years
Leasehold improvements	Lease term
Transportation equipment	5 years

Depreciation expense on other equipment for the years ended December 31, 2018 and 2017 was $290,864 and $309,045, respectively.

The Company reviews long-lived assets to be held and used for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. When required, impairment losses are recognized based on the excess of the asset's carrying value over the fair value of the asset. No impairments on other equipment were recorded in 2018 and 2017.

Canaan Resources, LLC

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE A - NATURE OF OPERATIONS AND SUMMARY OF ACCOUNTING POLICIES - CONTINUED

5. Deferred Financing Costs

The Company capitalizes costs associated with new financings and amortizes the deferred costs over the life of the loans using the straight-line method. Included in other assets at December 31, 2018 and 2017 was $34,976 and $50,791, respectively, of deferred financing costs, net of accumulated amortization of $1,882,090 and $1,801,640, respectively, related to the Company's revolving credit facility. Amortization of deferred financing costs of $80,450 and $87,157 for the years ended December 31, 2018 and 2017, respectively, is included in interest expense.

6. Revenue Recognition

The Company records revenues from oil and natural gas sales when the price is fixed or determinable, delivery to the purchaser has occurred, title has transferred and collectability is likely.

7. Production and Severance Taxes

The Company receives various tax rebates and rate reductions from state and local governments for certain of its properties. Approval of these exemptions or rate reductions is on a well by well basis, and credits are not recognized until approvals are received.

8. Income Taxes

The Company is an LLC taxed as a partnership, and any associated tax liability is the responsibility of the individual members of the LLC. Accordingly, no provision for income taxes has been made in these financial statements.

The Company disallows the recognition of tax positions not deemed to meet a "more-likely-than-not" threshold of being sustained by the applicable tax authority. With few exceptions, the Company is no longer subject to U.S. Federal or state income tax examinations by tax authorities for years prior to 2015. The Company's policy is to reflect interest and penalties related to uncertain tax positions in general and administrative expense, when and if they become applicable. The Company has not recognized any potential interest or penalties in its financial statements for the years ended December 31, 2018 and 2017.

9. Concentrations of Credit Risk and Major Customers

The Company is subject to credit risk resulting from the concentration of its oil and natural gas receivables with its significant customers. The Company extends credit to purchasers of its oil and natural gas, which are primarily other energy companies. In 2018 and 2017 the Company had three and four purchasers, respectively, whose purchases represented 89% and 86%, respectively, of oil and natural gas sales.

Additionally, at December 31, 2018 and 2017 the Company had receivables from three and four purchasers, respectively, which accounted for 92% and 86%, respectively, of oil and natural gas receivables. The Company does not require collateral and does not believe the loss of any single purchaser would materially impact its operating results.

Canaan Resources, LLC

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE A - NATURE OF OPERATIONS AND SUMMARY OF ACCOUNTING POLICIES - CONTINUED

10. Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions in determining the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates affecting these financial statements include estimates of the Company's oil and natural gas reserves (which are used to compute depreciation, depletion, amortization and impairment of oil and natural gas properties), asset retirement obligations, fair value of derivative instruments, accrued oil and gas sales, and others.

11. Natural Gas Balancing

In certain instances, the owners of the natural gas produced from a well will select different purchasers for their respective ownership interest in the wells. If one purchaser takes more than its ratable portion of the natural gas, the owners selling to that purchaser will be required to satisfy the imbalance in the future by cash payments or by allowing the other owners to sell more than their share of production.

The Company recognizes income on the sales method and, accordingly, has recognized revenue on all production delivered to its purchasers. To the extent the Company has over-produced its ownership percentage on a well and the remaining reserves are sufficient to enable the other owners to recover this imbalance from future production, no liability is recorded by the Company. The Company has no significant imbalances at December 31, 2018 and 2017.

12. Fair Value of Financial Instruments

The Company's financial instruments consist primarily of cash, trade receivables, trade payables, derivative instruments and debt. The carrying value of cash, trade receivables and payables are considered to be representative of their respective fair values due to the short maturity of these instruments. Derivative instruments are reported at fair value. The carrying value of debt approximates fair value as the debt has a variable rate and terms reflective of current market conditions.

13. Derivative Instruments

The Company has recorded derivative instruments at fair value and included them in the balance sheets as assets or liabilities. The accounting for changes in the fair value of a derivative instrument depends on the intended use of the derivative and the resulting designation, which is established at the inception of a derivative.

For derivative instruments not designated as cash flow hedges for accounting purposes, the unrealized change in fair value is recognized in current earnings as a separate line item on the statements of operations and any realized gains or losses upon settlement are recorded in oil and natural gas sales. No derivatives were accounted for as cash flow hedges during 2018 and 2017.

Canaan Resources, LLC

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE A - NATURE OF OPERATIONS AND SUMMARY OF ACCOUNTING POLICIES - CONTINUED

14. Asset Retirement Obligations

The Company records the fair value of a liability for an asset retirement obligation in the period in which it is incurred and a corresponding increase in the carrying amount of the related long-lived asset. The Company's asset retirement obligations relate to estimated future plugging and abandonment costs on its oil and natural gas properties and related facilities disposal. These obligations to abandon and restore properties are based upon estimated future costs which may change based upon future inflation rates and changes in statutory remediation rules. The accretion expense due to the passage of time is included in depreciation, depletion and amortization in the accompanying statements of operations.

The activity incurred in asset retirement obligations is as follows for the years ended December 31:

	2018	2017
Asset retirement obligations at January 1	$ 4,600,574	$ 4,416,059
Revisions	145,579	(127,378)
Liabilities incurred	84,546	-
Accretion expense	324,984	311,893
Asset retirement obligations at December 31	$ 5,155,683	$ 4,600,574

15. Recently Issued Accounting Standards not yet Adopted

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606), which outlines a new, single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. This new revenue recognition model provides a five-step analysis in determining when and how revenue is recognized. The new model will require revenue recognition to depict the transfer of promised goods or services to customers in an amount that reflects the consideration a company expects to receive in exchange for those goods or services. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which deferred the effective date of ASU 2014-09 by one year. That new standard, as amended and updated to clarify specific topics, is now effective for annual reporting periods beginning after December 15, 2018. An entity can apply ASU 2014-09 using either a full retrospective method, meaning the standard is applied to all of the periods presented, or a modified retrospective method, meaning the cumulative effect of initially applying the standard is recognized in the most current period presented in the financial statements. The Company is evaluating the impact that this new guidance will have on its financial statements and has not yet determined which method it will apply upon adoption.

In February 2016, the FASB issued ASU 2016-02, Leases, which requires lessees to recognize at the commencement date for all leases, with the exception of short-term leases, (a) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis, and (b) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. This ASU is effective for annual periods beginning after December 15, 2019. The Company is evaluating the impact of the adoption of this ASU on its financial statements.

Canaan Resources, LLC

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE A - NATURE OF OPERATIONS AND SUMMARY OF ACCOUNTING POLICIES - CONTINUED

15. Recently Issued Accounting Standards not yet Adopted - continued

Other accounting standards that have been issued or proposed by the FASB, or other standards-setting bodies, that require adoption at a future date are not expected to have a material impact on the financial statements upon adoption.

16. Liquidity, Going Concern and Management's Plans

Throughout 2018 the Company participated in drilling 9 new wells proposed by other operators. The Company's obligations in these wells ranged from less than 1% to 20%. Approximately $2.8 million of capitalized costs associated with these wells are included in accounts payable at December 31, 2018. Subsequent to year end, approximately $2.5 million of these costs were paid. As of the date these financial statements were available to be issued, approximately $0.3 million remains outstanding related to these obligations. The Company expects the remainder to be paid as billed. The Company's participation in future drilling proposed by other operators is subject to the availability of capital, which is likely to only come from free cash flows or asset sales.

The accompanying financial statements have been prepared under the assumption that the Company will continue as a going concern, which contemplates the continuity of operations and the realization of assets and the satisfaction of liabilities as they come due in the normal course of business. Throughout 2018 the Company paid down the outstanding note payable from $24.9 million to $21 million, with no remaining availability, as required by the terms set forth in the Sixteenth Amendment to the Credit Agreement. During February 2019, the bank requested additional principal payments of $1 million per quarter through June 30, 2019. The first requested non-contractual payment was due March 31, 2019 and it was not made. Management has notified the bank that due to the cash requirements associated with the aforementioned well activity it does not believe there will be sufficient cash resources to make the requested quarterly principal payments or to pay off the remaining principal balance at June 30, 2019 without selling certain of the Company's assets. If the Company is unable to reduce the outstanding debt to levels approved by the bank, the maturity date of the note will not be extended beyond June 30, 2019. Therefore, the note payable has been classified as a current liability resulting in a net working capital deficit of approximately $17.7 million at December 31, 2018. Additionally, as of the date of issuance of these financial statements, the Company was not in compliance with the audited financial statement deadline, which is no later than 105 days after the end of the fiscal year, and requirement for an unqualified audit opinion without a going concern or like modification contained in the credit facility. These covenant defaults give the lenders the right to accelerate all obligations due under the credit facility, although to date no such acceleration has occurred other than the requested quarterly principal reductions. The Company is in the process of reviewing options for asset sales which is anticipated to satisfy the bank debt for a one-year extension; however, the Company is not expected to complete the process before June 30, 2019 when the note becomes due.

These factors raise substantial doubt about the Company's ability to continue as a going concern. The accompanying financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts of liabilities that might result from this uncertainty

NOTE B - OIL AND NATURAL GAS INFORMATION

Costs related to the oil and natural gas activities of the Company, including those relating to property acquisitions, were incurred as follows for the years ended December 31:

Canaan Resources, LLC

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE B - OIL AND NATURAL GAS INFORMATION - CONTINUED

	2018	2017
Property acquisition costs - proved and unproved	$ 135,280	$ 155,768
Development costs	4,857,963	309,086
	$ 4,993,243	$ 464,854

Property acquisition and development costs shown above include $230,125 and ($127,378) of asset retirement costs for the years ended December 31, 2018 and 2017, respectively.

The Company had the following aggregate capitalized costs relating to oil and natural gas activities at December 31:

	2018	2017
Oil and natural gas properties subject to amortization	$ 294,179,777	$ 288,415,204
Unproved oil and natural gas properties (excluded from amortization)	16,820,290	17,605,000
Support facilities	10,792,144	10,778,765
	321,792,211	316,798,969
Less accumulated depreciation, depletion, amortization and impairment	264,229,924	259,884,412
	$ 57,562,287	$ 56,914,557

Depreciation, depletion and amortization expense was $3,946,061 or $0.87 per equivalent Mcf of production, and $3,882,920 or $0.85 per equivalent Mcf of production, for the years ended December 31, 2018 and 2017, respectively. For the year ended December 31, 2018, the Company recorded a ceiling test impairment of oil and natural gas properties of $399,451. No impairment was recorded for the year ended December 31, 2017.

NOTE C - NOTE PAYABLE TO BANK

In June 2005, the Company entered into a $200 million secured revolving credit facility with a bank. This facility provides for revolving credit equal to the lesser of $200 million or a borrowing base that is reevaluated semi-annually based on the value of the Company's oil and natural gas reserves as determined in accordance with the credit facility. At December 31, 2018, the borrowing base was $21 million, of which $21 million was outstanding. There was no additional available borrowing capacity at December 31, 2018. At December 31, 2017, the borrowing base was $29.5 million, of which $24.9 million was outstanding.

Borrowings under the facility are secured by substantially all of the Company's oil and natural gas properties. The terms of the facility give the Company the option of either borrowing at a base rate approximating prime or at LIBOR rates, plus margins that vary based on borrowing base utilization percentages. Commitment fees are 0.50% of the unused commitment in effect for the applicable period and are payable quarterly. At December 31, 2018, the Company's weighted average borrowing rate was 6.31% (5.00% at December 31, 2017).

Canaan Resources, LLC

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE C - NOTE PAYABLE TO BANK - CONTINUED

The outstanding borrowings are evidenced by a term note due June 30, 2019. In June 2018 the maturity date was extended to June 30, 2019. The Company paid extension fees of $50,000, equal to 20 bps on the existing borrowing base at the time of the extension. Principal and any unpaid interest are due on June 30, 2019. See Note A-16 for further discussion of when payments are due.

The credit facility contains affirmative and restrictive covenants including the maintenance of various financial ratios, among other things. The Company was not in compliance with the audited financial statement deadline, which is no later than 105 days after the end of the fiscal year, and requirement for an unqualified audit opinion without a going concern or like modification contained in the credit facility as of the date of issuance of these financial statements. The Company was in compliance with all other financial covenants at December 31, 2018.

NOTE D - MEMBERS' EQUITY

Capitalization of the Company is provided by the sale of membership interests to its three members (see Note A for names and percentage ownerships). These three members are funded by capital calls made to their respective general and limited partners. The members in turn purchase membership interests from the Company as capital is needed. During 2018 and 2017 the purchases of membership interest totaled $0 and $250,000, respectively. At December 31, 2018 the members have combined remaining capital commitments of approximately $12,628,000 which may be used to make future purchases of membership interests in the Company. The partnerships do not anticipate calling any of the remaining capital commitments. No distributions were made during 2018 or 2017.

The governance of the business and affairs of the Company and the rights and obligations of members are established pursuant to an operating agreement. This operating agreement provides, among other things, that profit and loss and distributions shall be allocated to the members in proportion to their capital account balances. Additionally, the agreement sets forth guidelines regarding replacement of management, management salaries and limitation of indebtedness, as defined.

NOTE E - RELATED PARTY TRANSACTIONS

General and administrative ("G&A") expenses and certain capitalized items, including furniture and fixtures, computer hardware, and other non-oil and gas expenditures required to carry on business, are shared between the Company and two affiliated entities, Canaan Resources X, LLC ("CRX") and Canaan Resources Drilling Company, LLC ("CRDC"). Certain personnel costs and other expenses are directly charged to CRDC and are not borne by the Company or CRX. CRDC is otherwise allocated one-third of shared G&A expenses and other non-oil and gas expenditures. Allocation of the remaining two-thirds of G&A is split between the Company and CRX, as prescribed in an agreement entered into between the two entities in 2008. Under this agreement, management salary allocations are fixed, and all non-management personnel costs are allocated based on each party's percentage of total called capital. All remaining G&A is split 50-50. The Company generally incurs G&A on behalf of the affiliates and bills each for its allocated share. During 2018, the Company allocated expenses of $1,761,997 and $1,073,569 to CRX and CRDC, respectively. At December 31, 2018 the Company has corresponding receivables from CRX and CRDC of $66,299 and $38,436, respectively. During 2017, the Company allocated expenses of $1,663,524 and $1,002,979 to CRX and CRDC, respectively. At December 31, 2017 the Company had corresponding receivables from CRX and CRDC of $107,334 and $14,959, respectively.

NOTE E - RELATED PARTY TRANSACTIONS - CONTINUED

The payable or receivable is included in due to/from affiliates on the accompanying balance sheets and the allocated expense is a reduction of general and administrative expenses on the accompanying statements of operations.

In addition to the receivable related to the allocated expense above, the Company has a net receivable from CRX for operating costs incurred in the normal course of business of $65,513 and $67,505 and a net receivable from CRDC for operating costs incurred in the normal course of business of $155,890 and $19,758 for the years ended December 31, 2018 and 2017, respectively.

Included in due from affiliates at December 31, 2018 and 2017 are receivables of the Company from certain members and affiliates for $729,968 and $536,471, respectively.

NOTE F - COMMITMENTS AND CONTINGENCIES

Beginning July 1, 2014 CRDC entered into a lease agreement to rent office space from a non-affiliated party. The lease is for a term of 10 years with base lease payments of approximately $36,000 per month for the first 5 years and approximately $39,000 per month for the remainder of the lease. After making an allocation through the sharing agreement outlined in Note E, the Company has a net expense of approximately $12,000 per month, equivalent to one-third of the monthly base rent. Along with other affiliates, the Company has guaranteed the obligations of the lessee under the terms of the lease agreement.

The Company leases various computer and office equipment from the manufacturers through operating leases which run through 2020. Future minimum lease payment obligations on these operating leases, assuming the full term of the leases, are as follows:

Year ending December 31,	Equipment leases
2019	$ 17,977
2020	11,892

Rent expense under the equipment leases was $33,678 and $36,054 for the years ended December 31, 2018 and 2017, respectively.

The Company is subject to legal proceedings and claims which arise in the ordinary course of business. Management is not aware of any such actions that could materially affect the financial position or results of operations of the Company.

The Company is exposed to possible environmental risks which are inherent with oil and natural gas drilling and production operations. The Company has implemented various policies and procedures to avoid environmental contamination and to minimize the associated risks. The Company's operated oil and natural gas properties are reviewed periodically for indications of environmental contamination or potential exposure. Environmental expenditures are expensed as incurred. Liabilities for expenditures are recorded when environmental assessment and/or remediation is probable and the costs can be reasonably estimated. The Company has not experienced any significant environmental liability and is not aware of any potential material environmental issues or claims at December 31, 2018.

Canaan Resources, LLC

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE G - EMPLOYEE BENEFITS

The Company has a retirement plan covering substantially all qualified employees under section 401(k) of the Internal Revenue Code. Under the plan, participants may contribute up to a dollar limit provided by Internal Revenue Service guidelines (changing annually) to their plan accounts. The Company may make discretionary matching contributions to each participant's account. For the years ended December 31, 2018 and 2017, the Company made a discretionary contribution to the plan of $226,732 and $229,359, respectively.

NOTE H - DERIVATIVE ACTIVITIES AND FINANCIAL INSTRUMENTS

1. Derivative Activities

The Company's results of operations and operating cash flows are impacted by changes in market prices for oil and natural gas. To mitigate a portion of this exposure, the Company has entered into certain derivative instruments. The Company's derivative contracts in place consist of fixed price swaps covering both the NYMEX price and associated basis differentials. As of December 31, 2018, the Company has fixed price swap contracts in place through March 31, 2020 for a total of approximately 3.5 Bcf of anticipated natural gas production. For these fixed price swaps, the Company receives a fixed price for the hedged commodity and pays a floating market price, as defined in each instrument, to the counterparty. The fixed price payment and the floating price payment are netted, resulting in a single payment to or from the counterparty. The Company does not use derivative instruments for trading or speculative purposes. No contracts were terminated in 2018 or 2017.

All derivative instruments are recorded at fair value and included in the balance sheets as assets or liabilities. The following table summarizes the location and fair value amounts of all derivative instruments in the balance sheets as of December 31, 2018 and 2017:

	Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
2018				
Derivatives Not Designated as Cash Flow Hedges				
Fixed Price Swap Contracts	Derivative instruments short-term	$ 534,147	Derivative instruments short-term	$ 104,425
Fixed Price Swap Contracts	Derivative instruments long-term	43,906	Derivative instruments long-term	-
Total derivatives not designated as hedging instruments		$ 578,053		$ 104,425
2017				
Derivatives Not Designated as Cash Flow Hedges				
Fixed Price Swap Contracts	Derivative instruments short-term	$ 1,704,672	Derivative instruments short-term	$ -
Fixed Price Swap Contracts	Derivative instruments long-term	-	Derivative instruments long-term	-
Total derivatives not designated as hedging instruments		$ 1,704,672		$ -

Canaan Resources, LLC

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE H - DERIVATIVE ACTIVITIES AND FINANCIAL INSTRUMENTS - CONTINUED

1. Derivative Activities - continued

The following table summarizes the outstanding natural gas derivative contracts the Company has in place as of December 31, 2018:

Effective Date	Maturity Date	Notional Mcf Per Month	Remaining Notional Mcf	Fixed Price per Mcf	Floating Price	Hedge Designation
1/1/2019	12/31/2019	110,000	1,320,000	$2.7700	NYMEX	Not Designated
1/1/2019	3/31/2020	60,000	900,000	$2.9870	NYMEX	Not Designated
1/1/2019	3/31/2020	85,920	1,288,799	$3.2197	NYMEX	Not Designated

2. Fair Value of Financial Instruments

Certain financial assets and liabilities are measured at fair value on a recurring basis. As defined in the accounting standards, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The accounting standards require disclosure that establishes a framework for measuring fair value and expands disclosure about fair value measurements and requires fair value measurements be classified and disclosed in one of the following categories:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities. We consider active markets as those in which transactions for the assets or liabilities occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2: Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability. This category includes those derivative instruments that we value using observable market data. Substantially all of these inputs are observable in the marketplace throughout the full term of the derivative instrument, can be derived from observable data, or supported by observable levels at which transactions are executed in the marketplace. Instruments in this category include non-exchange traded derivatives such as over-the-counter commodity price swaps.

Level 3: Measures based on prices or valuation models that require inputs that are both significant to the fair value measurement and less observable from objective sources (i.e., supported by little or no market activity).

In accordance with the accounting standards, financial assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of the fair value of assets and liabilities and their placement within the fair value hierarchy levels.

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NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE H - DERIVATIVE ACTIVITIES AND FINANCIAL INSTRUMENTS - CONTINUED

2. Fair Value of Financial Instruments - continued

The following table sets forth by level within the fair value hierarchy the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2018 and 2017:

	2018			
	Level 1	Level 2	Level 3	Total
Assets				
Commodity derivatives	$ -	$ 578,053	$ -	$ 578,053
Liabilities				
Commodity derivatives	$ -	$ 104,425	$ -	$ 104,425

	2017			
	Level 1	Level 2	Level 3	Total
Assets				
Commodity derivatives	$ -	$ 1,704,672	$ -	$ 1,704,672
Liabilities				
Commodity derivatives	$ -	$ -	$ -	$ -

NOTE I - SUBSEQUENT EVENTS

The Company has evaluated events and transactions subsequent to December 31, 2018 through April 23, 2019, the date these financial statements were available to be issued, for potential recognition or disclosure in these financial statements. With the exception of those matters discussed in Notes A and C, there were no material subsequent events that required recognition or additional disclosure in these financial statements.